

Amendment Offered by Mr. Levin of Michigan

This amendment would provide that carried interest compensation is taxed as ordinary income and excludes it from business income under Section 1004.

AMENDMENT**OFFERED BY MR. LEVIN OF MICHIGAN**

Add at the end of title III the following:

Subtitle J—Carried Interest**SEC. 3901. PARTNERSHIP INTERESTS TRANSFERRED IN
CONNECTION WITH PERFORMANCE OF SERVICES.**

(a) MODIFICATION TO ELECTION TO INCLUDE PARTNERSHIP INTEREST IN GROSS INCOME IN YEAR OF TRANSFER.—Subsection (c) of section 83 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

“(4) PARTNERSHIP INTERESTS.—Except as provided by the Secretary—

“(A) IN GENERAL.—In the case of any transfer of an interest in a partnership in connection with the provision of services to (or for the benefit of) such partnership—

“(i) the fair market value of such interest shall be treated for purposes of this section as being equal to the amount of the distribution which the partner would receive if the partnership sold (at the time of

1 **"SEC. 710. SPECIAL RULES FOR PARTNERS PROVIDING IN-**
2 **VESTMENT MANAGEMENT SERVICES TO**
3 **PARTNERSHIPS.**

4 "(a) TREATMENT OF DISTRIBUTIVE SHARE OF
5 PARTNERSHIP ITEMS.—For purposes of this title, in the
6 case of an investment services partnership interest—

7 "(1) IN GENERAL.—Notwithstanding section
8 702(b)—

9 "(A) an amount equal to the net capital
10 gain with respect to such interest for any part-
11 nership taxable year shall be treated as ordi-
12 nary income, and

13 "(B) subject to the limitation of paragraph
14 (2), an amount equal to the net capital loss
15 with respect to such interest for any partner-
16 ship taxable year shall be treated as an ordi-
17 nary loss.

18 "(2) RECHARACTERIZATION OF LOSSES LIM-
19 ITED TO RECHARACTERIZED GAINS.—The amount
20 treated as ordinary loss under paragraph (1)(B) for
21 any taxable year shall not exceed the excess (if any)
22 of—

23 "(A) the aggregate amount treated as ordi-
24 nary income under paragraph (1)(A) with re-
25 spect to the investment services partnership in-

1 terminated under section 1222, except that such
2 section shall be applied—

3 “(i) without regard to the recharacter-
4 ization of any item as ordinary income or
5 ordinary loss under this section,

6 “(ii) by only taking into account items
7 of gain and loss taken into account by the
8 holder of such interest under section 702
9 (other than subsection (a)(9) thereof) with
10 respect to such interest for such taxable
11 year, and

12 “(iii) by treating property which is
13 taken into account in determining gains
14 and losses to which section 1231 applies as
15 capital assets held for more than 1 year.

16 “(B) NET CAPITAL LOSS.—The term ‘net
17 capital loss’ means the excess of the losses from
18 sales or exchanges of capital assets over the
19 gains from such sales or exchanges. Rules simi-
20 lar to the rules of clauses (i) through (iii) of
21 subparagraph (A) shall apply for purposes of
22 the preceding sentence.

23 “(5) SPECIAL RULE FOR DIVIDENDS.—Any div-
24 idend allocated with respect to any investment serv-
25 ices partnership interest shall not be treated as

1 “(iii) any amount that would have
2 been treated as ordinary income under this
3 subsection had the decedent sold such in-
4 terest immediately before death shall be
5 treated as an item of income in respect of
6 a decedent under section 691.

7 “(2) LOSS.—Any loss on the disposition of an
8 investment services partnership interest shall be
9 treated as an ordinary loss to the extent of the ex-
10 cess (if any) of—

11 “(A) the aggregate amount treated as ordi-
12 nary income under subsection (a) with respect
13 to such interest for all partnership taxable
14 years to which this section applies, over

15 “(B) the aggregate amount treated as or-
16 dinary loss under subsection (a) with respect to
17 such interest for all partnership taxable years
18 to which this section applies.

19 “(3) ELECTION WITH RESPECT TO CERTAIN EX-
20 CHANGES.—Paragraph (1)(A)(ii) shall not apply to
21 the contribution of an investment services partner-
22 ship interest to a partnership in exchange for an in-
23 terest in such partnership if—

24 “(A) the taxpayer makes an irrevocable
25 election to treat the partnership interest re-

1 distributive share of the taxable income of the
2 partnership would be treated under subsection
3 (a) if, immediately prior to the distribution, the
4 partnership had sold the distributed property at
5 fair market value and all of the gain from such
6 disposition were allocated to such partner. For
7 purposes of applying subsection (a)(2), any gain
8 treated as ordinary income under this subpara-
9 graph shall be treated as an amount treated as
10 ordinary income under subsection (a)(1)(A).

11 “(C) ADJUSTMENT OF BASIS.—In the case
12 a distribution to which subparagraph (A) ap-
13 plies, the basis of the distributed property in
14 the hands of the distributee partner shall be the
15 fair market value of such property.

16 “(D) SPECIAL RULES WITH RESPECT TO
17 MERGERS, DIVISIONS, AND TECHNICAL TERMI-
18 NATIONS.—In the case of a taxpayer which sat-
19 isfies requirements similar to the requirements
20 of subparagraphs (A) and (B) of paragraph (3),
21 this paragraph and paragraph (1)(A)(ii) shall
22 not apply to the distribution of a partnership
23 interest if such distribution is in connection
24 with a contribution (or deemed contribution) of
25 any property of the partnership to which sec-

1 “(2) BUSINESSES TO WHICH THIS SECTION AP-
2 PLIES.—A trade or business is described in this
3 paragraph if such trade or business primarily in-
4 volves the performance of any of the following serv-
5 ices with respect to assets held (directly or indi-
6 rectly) by one or more investment partnerships re-
7 ferred to in paragraph (1):

8 “(A) Advising as to the advisability of in-
9 vesting in, purchasing, or selling any specified
10 asset.

11 “(B) Managing, acquiring, or disposing of
12 any specified asset.

13 “(C) Arranging financing with respect to
14 acquiring specified assets.

15 “(D) Any activity in support of any service
16 described in subparagraphs (A) through (C).

17 “(3) INVESTMENT PARTNERSHIP.—

18 “(A) IN GENERAL.—The term ‘investment
19 partnership’ means any partnership if, at the
20 end of any two consecutive calendar quarters
21 ending after the date of enactment of this sec-
22 tion—

23 “(i) substantially all of the assets of
24 the partnership are specified assets (deter-
25 mined without regard to any section 197

1 the same trade or business as the upper-
2 tier partnership and is—

3 “(I) a partnership all of the cap-
4 ital and profits interests of which are
5 held directly or indirectly by the
6 upper-tier partnership, or

7 “(II) a foreign corporation which
8 does not engage in a trade or business
9 in the United States and all of the
10 stock of which is held directly or indi-
11 rectly by the upper-tier partnership.

12 “(C) SPECIAL RULES FOR DETERMINING
13 IF PROPERTY HELD IN CONNECTION WITH
14 TRADE OR BUSINESS.—

15 “(i) IN GENERAL.—Except as other-
16 wise provided by the Secretary, solely for
17 purposes of determining whether any inter-
18 est in a partnership constitutes property
19 held in connection with a trade or business
20 under subparagraph (A)(ii)—

21 “(I) a trade or business of any
22 person closely related to the owner of
23 such interest shall be treated as a
24 trade or business of such owner,

1 prevent the avoidance of the purposes of sub-
2 paragraph (A), including regulations or other
3 guidance which treat convertible and contingent
4 debt (and other debt having the attributes of
5 equity) as a capital interest in the partnership.

6 “(E) CONTROLLED GROUPS OF ENTI-
7 TIES.—

8 “(i) IN GENERAL.—In the case of a
9 controlled group of entities, if an interest
10 in the partnership received in exchange for
11 a contribution to the capital of the part-
12 nership by any member of such controlled
13 group would (in the hands of such mem-
14 ber) constitute property held in connection
15 with a trade or business, then any interest
16 in such partnership held by any member of
17 such group shall be treated for purposes of
18 subparagraph (A) as constituting (in the
19 hands of such member) property held in
20 connection with a trade or business.

21 “(ii) CONTROLLED GROUP OF ENTI-
22 TIES.—For purposes of clause (i), the term
23 ‘controlled group of entities’ means a con-
24 trolled group of corporations as defined in
25 section 1563(a)(1), applied without regard

1 “(A) IN GENERAL.—A person shall be
2 treated as related to another person if the rela-
3 tionship between such persons is described in
4 section 267(b) or 707(b).

5 “(B) ATTRIBUTION OF PARTNER SERV-
6 ICES.—Any service described in paragraph (2)
7 which is provided by a partner of a partnership
8 shall be treated as also provided by such part-
9 nership.

10 “(d) EXCEPTION FOR CERTAIN CAPITAL INTER-
11 ESTS.—

12 “(1) IN GENERAL.—In the case of any portion
13 of an investment services partnership interest which
14 is a qualified capital interest, all items of gain and
15 loss (and any dividends) which are allocated to such
16 qualified capital interest shall not be taken into ac-
17 count under subsection (a) if—

18 “(A) allocations of items are made by the
19 partnership to such qualified capital interest in
20 the same manner as such allocations are made
21 to other qualified capital interests held by part-
22 ners who do not provide any services described
23 in subsection (c)(2) and who are not related to
24 the partner holding the qualified capital inter-
25 est, and

1 terest represent a lower return than the alloca-
2 tions made to the other qualified capital inter-
3 ests referred to in such paragraph.

4 “(3) SPECIAL RULE FOR CHANGES IN SERVICES
5 AND CAPITAL CONTRIBUTIONS.—In the case of an
6 interest in a partnership which was not an invest-
7 ment services partnership interest and which, by
8 reason of a change in the services with respect to as-
9 sets held (directly or indirectly) by the partnership
10 or by reason of a change in the capital contributions
11 to such partnership, becomes an investment services
12 partnership interest, the qualified capital interest of
13 the holder of such partnership interest immediately
14 after such change shall not, for purposes of this sub-
15 section, be less than the fair market value of such
16 interest (determined immediately before such
17 change).

18 “(4) SPECIAL RULE FOR TIERED PARTNER-
19 SHIPS.—Except as otherwise provided by the Sec-
20 retary, in the case of tiered partnerships, all items
21 which are allocated in a manner which meets the re-
22 quirements of paragraph (1) to qualified capital in-
23 terests in a lower-tier partnership shall retain such
24 character to the extent allocated on the basis of

1 “(B) the distributive share of gain or loss
2 that would have been so allocated to the invest-
3 ment services partnership interest of which such
4 qualified capital interest is a part.

5 “(7) QUALIFIED CAPITAL INTEREST.—For pur-
6 poses of this section—

7 “(A) IN GENERAL.—The term ‘qualified
8 capital interest’ means so much of a partner’s
9 interest in the capital of the partnership as is
10 attributable to—

11 “(i) the fair market value of any
12 money or other property contributed to the
13 partnership in exchange for such interest
14 (determined without regard to section
15 752(a)),

16 “(ii) any amounts which have been in-
17 cluded in gross income under section 83
18 with respect to the transfer of such inter-
19 est, and

20 “(iii) the excess (if any) of—

21 “(I) any items of income and
22 gain taken into account under section
23 702 with respect to such interest, over

24 “(II) any items of deduction and
25 loss so taken into account.

1 sult from a termination, merger, consolidation,
2 or division described in section 708, or any
3 similar transaction.

4 “(8) TREATMENT OF CERTAIN LOANS.—

5 “(A) PROCEEDS OF PARTNERSHIP LOANS
6 NOT TREATED AS QUALIFIED CAPITAL INTER-
7 EST OF SERVICE PROVIDING PARTNERS.—For
8 purposes of this subsection, an investment serv-
9 ices partnership interest shall not be treated as
10 a qualified capital interest to the extent that
11 such interest is acquired in connection with the
12 proceeds of any loan or other advance made or
13 guaranteed, directly or indirectly, by any other
14 partner or the partnership (or any person re-
15 lated to any such other partner or the partner-
16 ship). The preceding sentence shall not apply to
17 the extent the loan or other advance is repaid
18 before the date of the enactment of this section
19 unless such repayment is made with the pro-
20 ceeds of a loan or other advance described in
21 the preceding sentence.

22 “(B) REDUCTION IN ALLOCATIONS TO
23 QUALIFIED CAPITAL INTERESTS FOR LOANS
24 FROM NONSERVICE-PROVIDING PARTNERS TO
25 THE PARTNERSHIP.—For purposes of this sub-

1 whose relationship to the grantor is de-
2 scribed in section 267(b)(1), and

3 “(iii) all other interests in such quali-
4 fied family partnership with respect to
5 which significant allocations are made
6 (within the meaning of paragraph (1)(B)
7 and in comparison to the allocations made
8 to the interest described in clause (ii)) are
9 held by persons who—

10 “(I) are related to the natural
11 person or trust referred to in clause
12 (ii), or

13 “(II) provide services described
14 in subsection (c)(2).

15 “(C) QUALIFIED FAMILY PARTNERSHIP.—
16 For purposes of this paragraph, the term
17 ‘qualified family partnership’ means any part-
18 nership if—

19 “(i) all of the capital and profits in-
20 terests of such partnership are held by—

21 “(I) specified family members,

22 “(II) any person closely related
23 (within the meaning of subsection
24 (c)(3)(C)(ii)) to a specified family
25 member, or

1 “(A) a person performs (directly or indi-
2 rectly) investment management services for any
3 investment entity,

4 “(B) such person holds (directly or indi-
5 rectly) a disqualified interest with respect to
6 such entity, and

7 “(C) the value of such interest (or pay-
8 ments thereunder) is substantially related to
9 the amount of income or gain (whether or not
10 realized) from the assets with respect to which
11 the investment management services are per-
12 formed,

13 any income or gain with respect to such interest
14 shall be treated as ordinary income. Rules similar to
15 the rules of subsections (a)(5) and (d) shall apply
16 for purposes of this subsection.

17 “(2) DEFINITIONS.—For purposes of this sub-
18 section—

19 “(A) DISQUALIFIED INTEREST.—

20 “(i) IN GENERAL.—The term ‘dis-
21 qualified interest’ means, with respect to
22 any investment entity—

23 “(I) any interest in such entity
24 other than indebtedness,

1 “(II) subject to a comprehensive
2 foreign income tax (as defined in sec-
3 tion 457A(d)(2)).

4 “(C) INVESTMENT MANAGEMENT SERV-
5 ICES.—The term ‘investment management serv-
6 ices’ means a substantial quantity of any of the
7 services described in subsection (e)(2).

8 “(D) INVESTMENT ENTITY.—The term ‘in-
9 vestment entity’ means any entity which, if it
10 were a partnership, would be an investment
11 partnership.

12 “(f) EXCEPTION FOR DOMESTIC C CORPORATIONS.—
13 Except as otherwise provided by the Secretary, in the case
14 of a domestic C corporation—

15 “(1) subsections (a) and (b) shall not apply to
16 any item allocated to such corporation with respect
17 to any investment services partnership interest (or
18 to any gain or loss with respect to the disposition of
19 such an interest), and

20 “(2) subsection (e) shall not apply.

21 “(g) COORDINATION WITH 25 PERCENT MAXIMUM
22 RATE ON BUSINESS INCOME OF INDIVIDUALS.—The fol-
23 lowing amounts shall not be taken into account in deter-
24 mining net business income or loss under section 4:

1 “(4) coordinate this section with the other pro-
2 visions of this title.

3 “(i) CROSS REFERENCE.—For 40-percent penalty on
4 certain underpayments due to the avoidance of this sec-
5 tion, see section 6662.”.

6 (b) APPLICATION OF SECTION 751 TO INDIRECT DIS-
7 POSITIONS OF INVESTMENT SERVICES PARTNERSHIP IN-
8 TERESTS.—

9 (1) IN GENERAL.—Subsection (a) of section
10 751 is amended by striking “or” at the end of para-
11 graph (1), by inserting “or” at the end of paragraph
12 (2), and by inserting after paragraph (2) the fol-
13 lowing new paragraph:

14 “(3) investment services partnership interests
15 held by the partnership,”.

16 (2) CERTAIN DISTRIBUTIONS TREATED AS
17 SALES OR EXCHANGES.—Subparagraph (A) of sec-
18 tion 751(b)(1) is amended by striking “or” at the
19 end of clause (i), by inserting “or” at the end of
20 clause (ii), and by inserting after clause (ii) the fol-
21 lowing new clause:

22 “(iii) investment services partnership
23 interests held by the partnership,”.

1 include so much of such amount as is attributable
2 to any portion of the investment services partnership
3 interest which is a qualified capital interest (deter-
4 mined under rules similar to the rules of section
5 710(d)).

6 “(3) EXCEPTION FOR PUBLICLY TRADED PART-
7 NERSHIPS.—Except as otherwise provided by the
8 Secretary, in the case of an exchange of an interest
9 in a publicly traded partnership (as defined in sec-
10 tion 7704) to which subsection (a) applies—

11 “(A) this section shall be applied without
12 regard to subsections (a)(3), (b)(1)(A)(iii), and
13 (f)(3), and

14 “(B) such partnership shall be treated as
15 owning its proportionate share of the property
16 of any other partnership in which it is a part-
17 ner.

18 “(4) RECOGNITION OF GAINS.—Any gain with
19 respect to which subsection (a) applies by reason of
20 paragraph (3) thereof shall be recognized notwith-
21 standing any other provision of this title.

22 “(5) COORDINATION WITH INVENTORY
23 ITEMS.—An investment services partnership interest
24 held by the partnership shall not be treated as an
25 inventory item of the partnership.

1 section 710(c)) held by the partner-
2 ship,

3 “(II) any gain on the disposition
4 of an investment services partnership
5 interest (as so defined) or a partner-
6 ship interest to which (in the hands of
7 the partnership) section 751 applies,
8 and

9 “(III) any income or gain taken
10 into account by the partnership under
11 subsection (b)(4) or (e) of section
12 710.

13 “(ii) EXCEPTION FOR QUALIFIED CAP-
14 ITAL INTERESTS.—A rule similar to the
15 rule of section 710(d) shall apply for pur-
16 poses of clause (i).

17 “(C) COORDINATION WITH OTHER PROVI-
18 SIONS.—Subparagraph (A) shall not apply to
19 any item described in paragraph (1)(E) (or so
20 much of paragraph (1)(F) as relates to para-
21 graph (1)(E)).

22 “(D) SPECIAL RULES FOR CERTAIN PART-
23 NERSHIPS.—

24 “(i) CERTAIN PARTNERSHIPS OWNED
25 BY REAL ESTATE INVESTMENT TRUSTS.—

1 “(I) Substantially all of the as-
2 sets of such partnership consist of in-
3 terests in one or more publicly traded
4 partnerships (determined without re-
5 gard to subsection (b)(2)).

6 “(II) Substantially all of the in-
7 come of such partnership is ordinary
8 income or section 1231 gain (as de-
9 fined in section 1231(a)(3)).

10 “(E) TRANSITIONAL RULE.—Subpara-
11 graph (A) shall not apply to any taxable year
12 of the partnership beginning before the date
13 which is 10 years after the date of the enact-
14 ment of this paragraph.”.

15 (d) IMPOSITION OF PENALTY ON UNDERPAY-
16 MENTS.—

17 (1) IN GENERAL.—Subsection (b) of section
18 6662 is amended by inserting after paragraph (7)
19 the following new paragraph:

20 “(8) The application of section 710(e) or the
21 regulations or other guidance prescribed under sec-
22 tion 710(g) to prevent the avoidance of the purposes
23 of section 710.”.

24 (2) AMOUNT OF PENALTY.—

1 “(A) IN GENERAL.—Paragraph (1) shall
2 not apply to any portion of an underpayment to
3 which section 6662 applies by reason of sub-
4 section (b)(8) unless—

5 “(i) the relevant facts affecting the
6 tax treatment of the item are adequately
7 disclosed,

8 “(ii) there is or was substantial au-
9 thority for such treatment, and

10 “(iii) the taxpayer reasonably believed
11 that such treatment was more likely than
12 not the proper treatment.

13 “(B) RULES RELATING TO REASONABLE
14 BELIEF.—Rules similar to the rules of sub-
15 section (d)(3) shall apply for purposes of sub-
16 paragraph (A)(iii).”.

17 (e) INCOME AND LOSS FROM INVESTMENT SERVICES
18 PARTNERSHIP INTERESTS TAKEN INTO ACCOUNT IN DE-
19 TERMINING NET EARNINGS FROM SELF-EMPLOYMENT.—

20 (1) INTERNAL REVENUE CODE.—

21 (A) IN GENERAL.—Section 1402(a) is
22 amended by striking “and” at the end of para-
23 graph (16), by striking the period at the end of
24 paragraph (17) and inserting “; and”, and by

1 “(B) all items of income, gain, loss, and
2 deduction allocated to such interest, and

3 “(C) the amounts treated as realized from
4 the sale or exchange of property other than a
5 capital asset under section 751 with respect to
6 such interest.

7 “(2) EXCEPTION FOR QUALIFIED CAPITAL IN-
8 TERESTS.—A rule similar to the rule of section
9 710(d) shall apply for purposes of applying para-
10 graph (1)(B).”.

11 “(2) SOCIAL SECURITY ACT.—Section 211(a) of
12 the Social Security Act is amended by striking
13 “and” at the end of paragraph (15), by striking the
14 period at the end of paragraph (16) and inserting “;
15 and”, and by inserting after paragraph (16) the fol-
16 lowing new paragraph:

17 “(17) Notwithstanding the preceding provisions
18 of this subsection, in the case of any individual en-
19 gaged in the trade or business of providing services
20 described in section 710(c)(2) of the Internal Rev-
21 enue Code of 1986 with respect to any entity, invest-
22 ment services partnership income or loss (as defined
23 in section 1402(m) of such Code) shall be taken into
24 account in determining the net earnings from self-
25 employment of such individual.”.

1 this section shall apply to taxable years ending after
2 the date of the enactment of this Act.

3 (2) PARTNERSHIP TAXABLE YEARS WHICH IN-
4 CLUDE EFFECTIVE DATE.—In applying section
5 710(a) of the Internal Revenue Code of 1986 (as
6 added by this section) in the case of any partnership
7 taxable year which includes the date of the enact-
8 ment of this Act, the amount of the net capital gain
9 referred to in such section shall be treated as being
10 the lesser of the net capital gain for the entire part-
11 nership taxable year or the net capital gain deter-
12 mined by only taking into account items attributable
13 to the portion of the partnership taxable year which
14 is after such date.

15 (3) DISPOSITIONS OF PARTNERSHIP INTER-
16 ESTS.—

17 (A) IN GENERAL.—Section 710(b) of such
18 Code (as added by this section) shall apply to
19 dispositions and distributions after the date of
20 the enactment of this Act.

21 (B) INDIRECT DISPOSITIONS.—The amend-
22 ments made by subsection (b) shall apply to
23 transactions after the date of the enactment of
24 this Act.